



September 14, 2015

Mr. Christopher Kirkpatrick
Secretary
Commodity Futures Trading Commission
Three Lafayette Center
1155 21st Street, N.W.
Washington, DC 20581

Re: Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants – Cross-Border Application of the Margin Requirements (RIN 3038-AC97)

Dear Mr. Kirkpatrick:

Better Markets Inc.¹ appreciates the opportunity to comment on the above-captioned request for comment on the cross-border application of the Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants (“Proposed Rule”), issued by the Commodity Futures Trading Commission (“CFTC” or “Commission”).

INTRODUCTION

Mismanaged, misunderstood, and incomplete margin procedures in the over-the-counter derivatives market were a major contributor to the financial crisis of 2008 and the chaos in global financial markets that followed it. The cost of that crisis has been in the trillions of dollars, and the economic wreckage has hurt tens of millions of Americans.² As a result, one of the most crucial reforms in the Dodd-Frank Act was the mandate to design and implement a robust system of mandatory margin exchange for uncleared over the counter derivatives markets to help avoid a repeat of this disaster.

¹ Better Markets, Inc. is a nonprofit organization that promotes the public interest in the capital and commodity markets, including in particular the rulemaking process associated with the Dodd-Frank Act.

² See Better Markets, *The Cost Of The Wall Street Collapse And Ongoing Economic Crisis Is More Than \$12.8 Trillion* (Sept. 15, 2012), available at <http://bettermarkets.com/sites/default/files/Cost%20Of%20The%20Crisis.pdf>.

We have previously commented on the Commission's Proposed Margin rule³, and are generally confident that the robust systems designed by the various U.S. regulators will provide an effective safety mechanism for the transactions they govern (provided they are fully enforced). More concerning, however, is the treatment of the many transactions that are or may be outside of the U.S. regime (by design, evasion or otherwise), but still pose serious risks to the U.S. financial system.

Despite the significant benefits proper margining brings to the safety and stability of the financial system, increased margin is often misunderstood by swap dealers as an additional "cost" to OTC derivatives trades, as it reduces the amount of leverage that can be obtained in a given transaction. In an attempt to avoid these costs, amongst other regulations imposed by Dodd-Frank, large U.S. banks and other U.S. swap dealers took actions to attempt to move their swaps transactions outside the express jurisdiction of Dodd-Frank by exalting the form over the substance of the rule - namely removing explicit guarantees of foreign subsidiaries⁴. However, merely erasing the word "guarantee" in the paperwork of the foreign affiliate does not change the substance of the backing and ultimate guarantee of the U.S. parent company.

Better Markets has detailed how this evasion merely results in "de facto" guaranteed foreign affiliates regardless of purported form and that, worst of all, the risk of these activities will still come back to the U.S. taxpayers and government.⁵ Commendably, the CFTC promptly began an investigation of these evasive tactics, and the Proposed Rule reflects one of the first regulatory efforts to combat them.

Viewed through this lens, the approach outlined in the Proposed Rule is likely sufficient to capture most entities that would otherwise fall outside the express scope of the CFTC's margin regime under the existing Cross-Border Guidance⁶, thus effectively countering the firms trying to expatriate their swaps entities and shift their swaps business (and jobs and revenues) overseas. However, the approach is a needlessly complicated and indirect way to tackle the "de-guaranteeing" issue, as it deviates from the existing Cross-Border guidance, and fails to address other rule protections that may have also motivated such evasive repapering.

³ "Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants (RIN 3038-AC97)" (December 2, 2014) *available at* <http://bettermarkets.com/sites/default/files/documents/CFTC%20-%20CL%20-%20Margin%20Requirements%20for%20Uncleared%20Swaps%20for%20Swap%20Dealers%20and%20Major%20Swap%20Participants%20-%202012-2-2014.pdf>, incorporated here as if fully set forth.

⁴ Burne, Katy April 27, 2014 Big U.S. Banks Make Swaps a Foreign Affair *available at* <http://www.wsj.com/articles/SB10001424052702304788404579520302570888332>

⁵ Cross Border Guarantee Fact Sheet (June 19, 2014) *available at* [https://www.bettermarkets.com%2Fsites%2Fdefault%2Ffiles%2FCross-Border%2520Guarantee%2520Fact%2520Sheet%25206-19-14%2520\(2\).pdf&usg=AFQjCNFA7qS0V4Pp6AppUJjuYUdNB4fI9g&sig2=EITx6UQqFvog4_PjUpoIrA](https://www.bettermarkets.com%2Fsites%2Fdefault%2Ffiles%2FCross-Border%2520Guarantee%2520Fact%2520Sheet%25206-19-14%2520(2).pdf&usg=AFQjCNFA7qS0V4Pp6AppUJjuYUdNB4fI9g&sig2=EITx6UQqFvog4_PjUpoIrA).

⁶ Interpretative Guidance and Policy Statement Regarding Compliance with Certain Swap Regulations, 78 FR 45292 (July 26, 2013) ("Guidance").

Better Markets has long been a proponent and defender of the embattled Cross-Border Guidance, and we continue to believe that the Guidance serves as a useful framework for handling the international implications of derivatives transactions⁷, though we recognize that certain improvements should be made to fortify its reach. In a previous letter submitted during the comment period for the Advanced Notice of Proposed Rulemaking for this proposed rule, Better Markets advocated that the Commission should adopt an approach outlined in the Guidance, but with certain enhancements found in the Entity-Level approach.⁸ Retaining the hard-fought strengths of the Guidance, while updating it to better account for industry's evasive tactics, is a simpler and more comprehensive approach to addressing the cross-border treatment of margin, and any potential evasion of the rules it governs.

Margin is quite literally the front line of defense against the potential contagion and catastrophe posed by our increasingly large and interconnected over-the-counter derivatives market. The Proposed Rule indicates that the Commission recognizes the importance of a robust margin regime that isn't thwarted by artificial borders and evasive tactics. We hope that the following comments are useful in developing a strong, yet simple, final rule.

COMMENTS

1. The Proposed Rule adds an unnecessary level of complexity and confusion to the cross-border application of the margin rule

The Agency's Cross-Border Guidance, after incorporating copious public comments and surviving a significant legal challenge by the financial industry, exists as a comprehensive framework to which the many Title VII swaps rules are expected to adhere. Designing this framework took an exceptional amount of time, deliberation and input, and for good reason, as it was intended to inform the application of a wide variety of different regulations, many of which interact or rely on each other, across international borders. Primary among its strengths is the coherence with which it treats the family of swaps rules – designating a consistent nomenclature and framework on which all the rules are based.

⁷ “Proposed Interpretive Guidance and Policy Statement: Cross-Border Application of Certain Swaps Provisions of the Commodity Exchange Act (RIN 3038-AD57)” (August 16, 2012) *available at* <http://bettermarkets.com/sites/default/files/CFTC-CL- Cross Border Delay- 8-16-12.pdf>; “Proposed Interpretive Guidance and Policy Statement: Cross-Border Application of Certain Swaps Provisions of the Commodity Exchange Act (RIN 3038-AD57)” (August 27, 2012) *available at* <http://www.bettermarkets.com/sites/default/files/CFTC- CL- Cross Border Application of swaps provisions 8-27-12.pdf>; and “Proposed Further Interpretive Guidance and Policy Statement: Cross-Border Application of Certain Swaps Provisions of the Commodity Exchange Act (RIN 3038-AD85)” (February 15, 2013) *available at* <http://bettermarkets.com/sites/default/files/CFTC- CL- Cross-Border further guidance- 2-15-13.pdf>, incorporated here as if fully set forth.

⁸ *Id.* at 3.

This surely provides clarity for regulated firms, and also ensures that any changes to the core concepts will apply consistently to all of the relevant rules. It is of course to be expected that small tweaks and revisions would be appropriate as the market adjusts to this new regime and evolves over time, but the core structure and applicability of this framework have been substantially, and repeatedly, agreed upon.

For this reason, the Commission's decision to deviate from the Guidance and design an individual cross-border application solely for the *margin* rule is as inexplicable as it is unhelpful, to regulators and market participants alike. For example, the Proposed Rule creates a new, less robust definition of "guarantee", for the purposes of the margin rule, but no other⁹. The Proposal justifies this pared-down definition as appropriate because it is applied in combination with a new category of "Foreign Consolidated Subsidiaries" (also a term created by and specific to this rule)¹⁰. However, it is not at all clear why a guarantee in the world of uncleared margin is economically or substantively divergent from a guarantee in the world of, say, a clearing mandate. Similarly, the Proposed Rule presents yet another regulatory definition of "U.S. Person"¹¹, which diverges from both the Guidance definition¹², as well as the definition used by the SEC¹³ in its swaps rules.

There is no substantial benefit to be gained by introducing these new concepts into the regulatory regime, but only applying them to a single rule. These concepts are universally applicable, and should be universally understood. If these new definitions and concepts present an improved framework for handling cross-border transactions, surely all relevant rules should be enhanced with such improved definitions. A separate and piecemeal approach to certain rules, or framework where definitions of core concepts vary

⁹ NOPR 80 FR 41384 "The Proposed Rule would define the term "guarantee" as an arrangement pursuant to which one party to a swap transaction with a non-U.S. counterparty has rights of recourse against a U.S. person guarantor (whether such guarantor is affiliated with the non-U.S. counterparty or is an unaffiliated third party) with respect to the non-U.S. counterparty's obligations under the relevant swap transaction."

¹⁰ NOPR 80 FR 41384 "In the Guidance, the Commission interpreted the term "guarantee" generally to include not only traditional guarantees of payment or performance of the related swaps, but also other formal arrangements that, in view of all the facts and circumstances, support the non-U.S. person's ability to pay or perform its swap obligations with respect to its swaps."

¹¹ NOPR 80 FR 41385 "The Commission notes that the definition of "guarantee" in the Proposed Rule is narrower in scope than the one used in the Guidance...The Commission, however, certain types of indemnity agreements, master trust agreements, liability or loss transfer or sharing agreements). The Commission understands that these other financial arrangements or support transfer risk directly back to the U.S. financial system, with possible significant adverse effects, in a manner similar to a guarantee with a direct recourse to a U.S. person. The Commission, however, believes that application of a narrower definition of guarantee for purposes of identifying those uncleared swaps that should be treated like uncleared swaps of a U.S. CSEs would reduce the potential for conflict with the non-U.S. CSE's home regulator."

¹² NOPR 80 FR 41383.

¹³ NOPR 80 FR 41383 "The Commission's definition of the term "U.S. person" as used in the Guidance included a prong (iv) which covered "any commodity pool, pooled account, or collective investment vehicle (whether or not it is organized or incorporated in the United States) of which a majority ownership is held, directly or indirectly, by a U.S. person(s)."

widely from rule to rule, is not a helpful or sensible strategy to approaching broad regulatory initiatives. The heightened complexity that results also undermines the prospects for broad compliance and efficient regulatory oversight and enforcement.

That is precisely why industry initially asked for the cross-border guidance and why the Commission issued the Guidance.

2. The Proposed Rule adequately addresses the issue of de-guaranteeing with respect to margin, but does not address other rules such as the SEF and clearing mandate

As explained in the Release, the primary concerns with the approach outlined in the Guidance were focused on the inadequate treatment of guaranteed affiliates, and implicitly, the phenomenon of firms seeking to create a loophole by trying to “de-guarantee” certain affiliates to evade the rules.¹⁴ It is true, to a large extent, that the Proposed Rule does in fact adequately capture many affiliates whose transactions may have escaped U.S. margin requirements through the Guidance approach. Primarily, this is accomplished by including specific treatment of Foreign Consolidated Subsidiaries.

According to the release:

“The proposed coverage of foreign subsidiaries of a U.S. person as a “Foreign Consolidated Subsidiary,”...whose swaps would not be eligible for the Exclusion under any circumstances...would address the concern that even without a guarantee, as defined under the Guidance or in the Proposed Rule, foreign subsidiaries of a U.S. person with a substantial nexus to the U.S. financial system are adequately covered by the margin requirements.”¹⁵

To the extent that the inclusion of Foreign Consolidated Subsidiaries is a meaningful improvement to the regulatory treatment of cross-border margin, and indeed an effective remedy to the attempted evasion, it is unclear why this inclusion would not be better-placed as an amendment to the Guidance, where other transaction-level requirements could also enjoy the benefit.

While the margin regulation is surely a meaningful motivator in firms’ decisions to try to de-guarantee their foreign affiliates via form over substance, it is by no means the only rule that firms have sought to evade. Rules such as Clearing and Swap Execution

¹⁴ NOPR 80 FR 41379 “However, under [the Guidance] approach, the margin requirements would apply to a non-US SD/MSP (whether or not it is a “guaranteed affiliate” or an “affiliate conduit”) only with respect to its uncleared swaps with a US person counterparty and a non-US counterparty that is a guaranteed affiliate or an affiliate conduit; the margin requirements would not apply to uncleared swaps with a non-US person counterparty that is not a guaranteed affiliate or an affiliate conduit. Where the non-US counterparty is a guaranteed affiliate or an affiliate conduit, the Commission would allow substituted compliance.”

¹⁵ NOPR 80 FR 41385.

Facility mandates have also been cited as rules that will inspire wide spread evasion.¹⁶ Surely, any effective benefit the Proposed Rule may bring in discouraging de-guaranteeing will not be shared by other rules that will continue to adhere to the Guidance approach.

Beyond the important consistency issues, such complicated new regimes highlight resource allocation issues as well. It is no secret that the CFTC continues to be starved for funding, and must not spend precious resources on the unnecessary implementation of multiple different regulatory regimes. A new, complicated, and largely redundant regime for this one rule is a disservice to the comprehensive existing Guidance. To the extent that changes are needed to better protect against evasion of these rules, making targeted, limited changes to the Guidance is both appropriate, and in the best interests of market participants as well as regulators.

CONCLUSION

We hope these comments are helpful in your consideration of the Proposed Rule.

Sincerely,



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¹⁶ “The moves mean any liability for those swaps lies solely with the offshore operation, which the banks have said will protect the U.S. parent from contagion. Yet without that tie to the U.S. parent, the contracts won't fall under U.S. jurisdiction and so won't be subject to strict rules set by the 2010 Dodd-Frank financial-overhaul law, including requirements that contracts historically traded over the telephone be traded publicly on U.S. electronic platforms.” Available at <http://www.wsj.com/articles/cftc-to-scrutinize-banks-shifting-trading-operations-overseas-1409916820>.